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SkyOptics, Inc.

2450 Marilouise Way, Suite 100, San Diego, California 92103
Phone: 619.692.0006 • *Fax:* 619.692.4307

11 Penn Plaza, 5th Floor, New York, New York 10001
Phone: 212.946.2855 • *Fax:* 212.946.2856

August 9, 1996

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Office of the Secretary
Federal Communications Commission
Washington, D.C. 20554

Dear Sir/Madam:

Enclosed are an original and eight copies of comments in response to the Fourth Notice of Proposed Rulemaking in CC Docket No. 92-297. Please place the original and four copies in the appropriate files and circulate one of the remaining four copies to each of the Commissioners. Thank you for your cooperation.

Sincerely,

Robert L. Shearing

Robert L. Shearing
Chairman and Chief Executive Officer

RLS
Enclosures

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ORIGINAL

Before The
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Rulemaking to Amend Parts 1, 2, 21, and 25 of the Commission's Rules to Redesignate the 27.5-29.5 GHz Frequency Band, to Reallocate the 29.5-30.0 Frequency Band, to Establish Rules and Policies for Local Multipoint Distribution Service and for Fixed Satellite Services	)))))))	CC Docket No. 92-297

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COMMENTS

Robert L. Shearing
Chairman and Chief Executive Officer
SkyOptics, Inc.
2450 Marilouise Way, Suite 100
San Diego, CA 92103
(619) 692-4309

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COMMENTS

I. INTRODUCTION AND SUMMARY

The Commission in this proceeding requests comment on the eligibility of incumbent local exchange carriers ("LECs") and cable operators (collectively, the "incumbents") to obtain local multipoint distribution service ("LMDS") licenses in the geographic areas they serve.

SkyOptics, Inc. ("SkyOptics") respectfully suggests that the Telecommunications Act of 1996 ("the Act") not only makes incumbent LECs and cable operators ineligible to acquire LMDS licenses in their geographic service areas, it makes them ineligible to acquire LMDS licenses anywhere in the U.S. until their existing market power is substantially dissipated, thereby representing less danger to competition.

LMDS represents the possibility of facilities-based competition to incumbent LECs and cable operators, and prove to be the only source of facilities-based competition in these markets that is both economically viable and physically deployable in a relatively universal fashion throughout the U.S. over the course of the next decade. Therefore, proper application of the relevant sections of the Act, and of the antitrust laws to which they refer, is crucial to achieving the two most important goals of the Act as stated in the preamble: "lower prices and higher quality services for American telecommunications consumers" and encouraging "the rapid deployment of new telecommunications technologies."

II. THE ANTITRUST LAWS ARE FULLY APPLICABLE TO THE TELECOMMUNICATIONS INDUSTRY

We begin the analysis by observing that the Act is not what many observers think it is: a license for existing monopoly telecommunications providers to immediately enter into other telecommunications markets without limitation. That this is not the intent is most immediately obvious in the case of the Bell Operating Companies, who are specifically prohibited in section 271 of the Act from offering in-region interLATA telephone service until the much-discussed "Competitive Checklist" of section 271(c)(2)(B) is satisfied.

But it is equally true for all monopoly providers, who although free to enter new product and geographic markets, may do so only to the extent consistent with sections 253(k) and 601(b) of the Act. Section 253(k) states that: "A telecommunications carrier may not use services that are not competitive to subsidize services that are subject to competition." This language makes no distinction between "in-region" vs. "out-of-region," or between "same product market" vs. "entirely new product market." Incumbent LECs and cable operators cannot, consistent with this section, be permitted to enter any new markets through the transfer of the market power they presently command in their existing markets. The result otherwise would be to inhibit competition rather than promote it.

Section 601(b) clarifies the full applicability of the antitrust laws, including section 7 of the Clayton Act, to the telecommunication industry. Historically, the industry has on occasion been afforded some limited immunities from the antitrust laws, or been held to differing substantive standards for determining the existence of antitrust violations. The logic, so far as it went, was that the presence of regulation partially mitigated the need for antitrust enforcement.

Between sections 253(k), 601(b) and the general intent of the Act as expressed in the preamble to "promote competition" and "reduce regulation," it can hardly be disputed that today Congress is attempting to convert the telecommunications industry into one with a business and regulatory regime like that of any other American industry. This means the end of supposedly "natural monopoly" service providers legally defending their monopoly turf with the most "unnatural" and anticompetitive of business practices.

SkyOptics interprets the Act to mean that as of February 8, 1996, the competitive actions of all telecommunications service providers are to be judged by the same antitrust standards as their counterparts in other industries. That means that incumbent LECs and cable operators can acquire LMDS licenses or licensees only if doing so would not violate the Sherman Act, the Clayton Act, the Federal Trade Commission Act and the other antitrust laws.

III. INCUMBENT ACQUISITION OF LMDS LICENSES FAILS ANTITRUST MERGER SCRUTINY

For the purpose of antitrust analysis, we can discern no basis for distinguishing between incumbent LEC and cable operator acquisition of LMDS licenses at auction and post-auction acquisition of LMDS licensees. In either case the transaction is functionally a merger or acquisition by the incumbent of an LMDS business. We therefore use the phrase "acquisition of LMDS licenses" to include acquisition of LMDS licenses via either of these methods.

Several of the antitrust laws prohibit mergers or acquisitions that may substantially lessen competition or tend to create a monopoly. These include section 7 of the Clayton Act, sections 1 of the Sherman Act and section 5 of the Federal Trade Commission Act. Section 2 of the Sherman Act prohibits monopolization and attempted monopolization generally, whether or not in an acquisition context. The application of this section will be discussed separately.

In interpreting the antitrust laws to determine whether a merger or acquisition would be likely to violate them, the Department of Justice and Federal Trade Commission follow an analysis described in their 1992 Horizontal Merger Guidelines,[1] ("*Guidelines*").

[1] Federal Register, Vol. 57, No. 176, September 10, 1992, S. 41552

The Commission should, we submit, also follow the *Guidelines* in determining whether incumbent LECs and cable operators are eligible to acquire LMDS licenses.

All steps in the analysis outlined in the *Guidelines* are for the purpose of providing insight into the following question: Will the acquisition create or enhance market power or facilitate its exercise? This is the standard by which acquisitions are judged for antitrust purposes. If the answer to the question is yes, the acquisition must be prohibited or competition will suffer and consumers will pay excessive prices; if the answer is no, then the acquisition must be assumed to be pro-competitive and in the best interest of consumers.

The first step in the analysis is to assess whether the acquisition would significantly increase concentration and result in a concentrated market, properly defined and measured. An acquisition is unlikely to create or enhance market power or facilitate its exercise unless it meets this condition. Here, the product markets at issue are the services presently offered by incumbent LECs and cable operators, both categories of which can potentially be delivered via LMDS networks. The geographic markets at issue are the potential combinations of the Basic Trading Areas ("BTAs") covered by the LMDS license(s) and the incumbents' existing service areas.

As an aid to measuring market concentration, the *Guidelines* use the Herfindahl-Hirschman Index ("HHI") which is calculated by summing the squares of the individual market shares of all the participants. In the average local exchange market, with incumbent market share of 99% and a single competitor with the remaining 1%, the HHI would be 9802 ($99^2 + 1^2$), close to the maximum of 10,000.

The average multichannel video distribution market is only marginally less concentrated. Using the market share numbers from the *Second Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, adopted by the Commission on December 7, 1995, we derive the HHI as follows: ($91^2 + 3^2 + 2^2 + 1^2 + 1^2$) = 8296, with the market shares representing traditional cable, home satellite dishes, direct broadcast satellite, SMATV and MMDS, respectively.

The *Guidelines* consider markets with an HHI above 1800 to be highly concentrated; both LEC services and multichannel video distribution easily qualify. In these highly concentrated markets, an acquisition that produces an increase in the HHI of more than 50 points potentially raises competitive concern, depending on the totality of the circumstances. Mergers that produce an increase in the HHI in concentrated markets of more than 100 points are presumed to create or enhance market power or facilitate the exercise of market power.

Calculating the HHI if the incumbent LECs and cable operators acquire LMDS licenses requires an estimate of the market share likely to be gained by LMDS licensees. It is widely believed that the LMDS licenses will be collectively sold at auction for billions of dollars, implying that an LMDS license represents a tangible prospect of significant market share. To take one of many potentially reasonable numbers, assume that an LMDS license translates into an average of 15% market share of both the LEC and multichannel video markets.

In the case of a BTA wholly contained in an incumbent LEC or cable operator's service area, allowing the incumbent LEC to acquire the LMDS license would yield an average HHI of 9802 for LEC services. This is unchanged, since the LMDS market share stays with the incumbent LEC. The average HHI in the multichannel video market would fall from 8296 to 6016 ($76^2 + 15^2 + 3^2 + 2^2 + 1^2 + 1^2$). (For purposes of simplicity, we assume that all 15% of LMDS market share is taken from traditional cable). In this scenario, the average of the LEC and multichannel video HHIs falls from 9049 to 7909, a difference of 1140.

Prohibiting the incumbent LEC and cable operator from acquiring the LMDS license, so that the LMDS licensee is by definition a new entrant, yields a similar drop in the multichannel video HHI. However, it will also produce a drop in the average LEC HHI from 9802 to 7282 ($84^2 + 15^2 + 1^2$). Thus the average of the LEC and multichannel video HHIs falls from 9049 to 6649, a difference of 2400.

In other words, using the given set of assumptions, allowing incumbent LECs to acquire in-region LMDS licenses would increase the average HHI by 1260 points over what they would be if LEC acquisition were prohibited. This increase is more than twelve times the 100 HHI points necessary to presume the creation or enhancement of market power or the facilitation of its exercise.

The above analysis suggests that forbidding in-region incumbent LECs and cable operators from acquiring LMDS licenses is an easy decision from an antitrust standpoint. The harder case is when incumbent LECs and cable operators acquire out-of-region LMDS licenses. Here, at first glance it might appear that the change in market concentration engendered by LMDS entry, as measured by the HHIs, would not be influenced by whether out-of-region incumbent LECs or cable operators acquired the LMDS license.

In our view, however, this appearance would be misleading, because the existing market power of incumbent LECs and cable operators in their home markets would have an impact on their average market shares in the out-of-region markets. To a great extent, a company with market power in its home market can decide whether to exercise its market power in the home market or utilize the market power to gain market share in another market. In this case, the danger in allowing incumbent LECs and cable operators to acquire out-of-region LMDS licenses is not so much that they would be likely to use their market power at home to subsidize the LMDS business elsewhere. Rather, the danger is that they would use their LMDS licenses to discourage out-of-region LECs and cable operators from using LMDS to compete against them.

Stated more bluntly, there is a substantial probability that incumbent LECs and cable operators would acquire LMDS licenses as an "insurance policy" against other LECs and cable operators, who themselves would acquire out-of-region LMDS licenses for the same reason. An incumbent LEC or cable operator who declines to acquire out-of-region LMDS licenses can do little to thwart LMDS-based competition in its home markets. An incumbent LEC or cable operator with a portfolio of out-of-region LMDS licenses may very well be in a position to retaliate against LMDS-based competition in its home territory with out-of-region LMDS-based competition in the competitor's home territory.

This behavior is a form of what the *Guidelines* refer to as "coordinated interaction" and is somewhat analogous to a doctrine of mutual protection/mutual retaliation. "You stay away from my monopoly market, and I'll stay away from yours," would probably be the unspoken but dominant foundation of the relationship between incumbents.

Incumbent LECs and cable operators would, we predict, generally find a way to meet LMDS build-out requirements out-of-region, but only barely and with minimalist LMDS systems that fail to take advantage of the full potential of the technology. Although incumbent LECs and cable operators are eager for the opportunity to acquire LMDS licenses, their real interest lies more in stifling LMDS than in encouraging its development.

The *Guidelines* note that the ability of industry participants to engage in coordinated interaction is one of the key factors in determining the risk of anticompetitive harm to the consumer. As for evaluating the risk of coordinated interaction, a long list of circumstances conducive to this behavior is discussed in the *Guidelines* and many of those circumstances are present here. Included among them are the following: high ability to detect and punish deviations from the coordinated behavior; high availability of key information concerning market conditions, transactions and individual competitors; high level of firm and product homogeneity; and similar pricing and marketing practices typically employed by firms in the market.

Most important of all, however, is the evidence provided by present market conditions. The Commission must know that the mutual protection/mutual retaliation scenario articulated above is not merely a theoretical possibility, because this is what is happening in LEC and multichannel video markets right now. For example, there is nothing, in theory, to prevent one Regional Bell Operating Company ("RBOC") from offering local exchange services in the home territory of another RBOC. Nor is there any theoretical reason that one cable operator cannot "overbuild" a cable system in the home territory of another.

Yet, with some minor exceptions, this has not happened. The RBOCs are eager to enter the long-distance telephone market. The RBOCs are eager to enter the multichannel video market. The RBOCs are even eager to enter into friendly mergers with each other. But are the RBOCs eager to attack each other's monopolies in the market for local exchange services, even as resellers? Not based on their track record. Likewise, the cable operators want to get into the local exchange market. They want to get into the Internet market. They want to acquire each other. But how many of them have initiated competition against their fellow cable operators in other regions? Not many.

This could all change, of course, and the incumbent LECs and cable operators would undoubtedly suggest that all of these events are just around the corner. But antitrust law does not allow the luxury of waiting around to find out. Antitrust law evaluates the potential anticompetitive impact of a transaction <u>before</u> it ever takes place. Of course, if these hypothetical events do occur as the incumbents predict, existing market power will be dissipated, and after that time incumbent LECs and cable operators would be permitted under the antitrust laws to acquire what will then be LMDS licensees.

It may strike the Commission as speculative or premature to consider these scenarios. However, the Commission should take heed of the *Guidelines* and the antitrust laws which it is required to interpret. Indeed, the *Guidelines* specifically "reflect the congressional intent that merger enforcement should interdict competitive problems <u>in their incipiency</u>." *Guidelines*, section 0.1 (emphasis added). Accordingly, the Commission cannot rely on the good faith assurances tendered by the participants nor on the canard that it lacks sufficient information to make difficult administrative decisions.

We believe the risk of consumer harm is extremely high if incumbent LECs and cable operators are allowed to acquire out-of-region LMDS licenses. Indeed, in the most likely scenario the HHI market concentration numbers would parallel those in the in-region scenario. If so, the average HHI would increase by over 1200 when a mere increase of 100 suffices to presume the creation or enhancement of market power, or the facilitation of its exercise.

IV. <u>THERE IS A DANGEROUS PROBABILITY THAT INCUMBENT ACQUISITION OF LMDS LICENSES WOULD VIOLATE SECTION 2 OF THE SHERMAN ACT.</u>

It is common in antitrust analysis that a set of circumstances that violates one antitrust provision will violate others as well. We suggest that this is the case here. To allow incumbent LECs and cable operators to acquire LMDS licenses would be to invite violations of Section 2 of the Sherman Act, which prohibits predatory pricing as a form of monopolization or attempted monopolization.

Because incumbent LECs and cable operators have market power to protect, there is a dangerous probability that they would place a higher value on LMDS licenses than justified by the revenue streams they project for LMDS-based services. This is a form of predatory pricing, whereby the incumbents would take a "loss" in the form of excessive LMDS license payments in exchange for continued monopoly profits in the future. Conditions permitting successful predatory pricing are extremely rare, since the losses are immediate and real and the monopoly profits distant and speculative. However, this is the rare case where the prospect of future monopoly profits is credible to the extent that LMDS may represent the only real threat of near term facilities-based competition in many markets.

Who loses when incumbent LECs and cable operators purchase in-region or out-of-region LMDS licenses as a partial insurance policy against LMDS-based competition? The consumer loses. Consumers are entitled to a choice of local exchange carriers and a choice of multichannel video providers anywhere that the capital investment required to build an alternative infrastructure (including license costs) can earn a sufficient return. When predatory behavior on the part of incumbents forces the cost of licenses artificially high, fewer competitive infrastructures can earn a sufficient return on investment and fewer competitive infrastructures are built.

Regrettably, even though incumbent LECs and cable operators would, if permitted to acquire LMDS licenses at auction, be willing to bid one dollar higher than the maximum amount that a new entrant would be willing to pay, in practice incumbents would be able to acquire the licenses for substantially less than this amount. This is because an auction is not a theoretical exercise: if capital markets understand that incumbents will pay whatever is necessary to protect their market power, they will not supply capital to new entrants merely to bid up the final prices paid by the incumbents. Consumers therefore lose twice, as consumers stuck with monopoly LECs and cable operators, and as taxpayers who receive less than the full value of the LMDS licenses.

Absent predatory pricing, the entities that would likely bid highest for the LMDS licenses are those that intend to use LMDS systems to deliver multiple telecommunications services. Given reasonable assurances that the vast majority of LMDS licenses will not go to incumbents based on predatory pricing, investors are likely to provide amounts of capital to new entrants commensurate with the quality of their business plans and their management.

Incumbent LECs and cable operators argue that only they can raise the large amounts of capital necessary to deploy LMDS networks. The history of capital markets in general and past FCC auctions in particular suggests otherwise. Once the capital markets were informed that C-block PCS licenses would be auctioned without the participation of incumbents, capital flowed to auction participants in record amounts. Although that particular auction was closed to all large companies, not just those with an incentive to protect existing market power, we expect that exclusion of incumbent LECs and cable operators, which we believe is mandated by the Telecommunications Act of 1996, would have a similarly salutary effect on the ability of new entrants to raise capital.

Indeed, we believe that vigorous antitrust enforcement, including the prevention of LMDS license acquisition by incumbent LECs and cable operators, would be sufficient to permit an entire generation of new telecommunications service providers to emerge in the marketplace. The more vigorous the antitrust enforcement now, the more quickly existing market power will dissipate, and the less frequently antitrust enforcement will be necessary in the future.

V. CONCLUSION

It might appear to the Commission that this is neither the time nor the place to consider these weighty issues, yet taking a pass on them now would be a grievous mistake. LMDS may be the last near-term opportunity to open up monopoly LEC and multichannel video markets. American consumers, who have largely come to be dissatisfied with the lack of market choice and variety resulting from the monopoly position of LECs and cable operators, deserve better.

The Commission should assume that blocking both in-region and out-of-region incumbent LEC and cable operator acquisition of LMDS licenses would invite much controversy and heated debate, possibly serving to delay the LMDS auction further. We submit, however, that so long as the existing telecommunications monopolies retain their market power, unending market distortions and consumer dissatisfaction will persist. SkyOptics respectfully requests that the Commission remain focused not on avoidance of controversy, but on the public interest. That interest clearly lies in the prospect that LMDS, if developed and deployed by entities without an incentive to constrain its growth, may play a key role in ending telecommunications monopolies once and for all.

The Commission should hold incumbent LECs and cable operators ineligible to acquire LMDS licenses, in-region or out-of-region.

Respectfully submitted,

SkyOptics, Inc.
2450 Marilouise Way, Suite 100
San Diego, CA 92103
(619) 692-4309

By: Robert L. Shearing

Robert L. Shearing
Chairman and Chief Executive Officer

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